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Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

No. 516

EUNICE E. EASTMAN,
Petitioner,

vs.

GUARANTY TRUST COMPANY OF NEW YORK, ET AL.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF.

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PETITIONER'S REPLY.

Respondents say (p. 7) that there was no breach of trust because: (1) there was no trust or fiduciary relationship between the respondents and the petitioner and (2) that the respondents did not receive any part of the

segregated assets and did not benefit by the offer. They also say that even assuming the existence of a fiduciary relationship there was no violation of duty, and petitioner suffered no loss by reason of the exchange. We will reply to the points and show that they are without merit.

The Trust Relationship. The proposition that there was no trust relationship is founded upon the contention that there was no trust *res*. The authorities cited in the petition (pp. 20-21) on the point that the transfer of the *rights* of the beneficiaries to the Trustee was in itself sufficient to constitute a trust *res*, are nowhere discussed in respondents' answer. The authorities which they cite may be applicable upon an issue between attaching judgment creditors and the Trustee prior to entry in possession or taking other steps to foreclose. In such a case the fact that the Trustee was not possessed of the trust assets might be of importance as to which lien attached first. The *Baldwin* case (90 F. (2d) 708) which they cited is one of such cases. This has *no bearing upon the question of the fiduciary or* trust relationship between the parties (*Flannery* v. *Flannery Bolt Co.*, 108 F. (2d) 531, 534).

The *Bradford* case (24 F. Supp. 28) which is cited by the court and by respondents dealt with a *constructive trust* and there being no trust *res* there could be no constructive trust. There, it was pointed out that a trust *res* may consist of a "chose in action" and the conclusion that there was no trust *res* was because there it was sought "to make a *res* out of a liability or to impress a trust therein". Here, it is sought to hold the Trustee liable for a breach of a trust duty relating to trust property which the trustee appropriated to its own use.

The *United States Cigar Store* case (70 F. (2d) 313) on which respondents rely is based on the fact that "there was no segregation" of the funds and there was no "putting aside" of such funds. Here, there were "segregated assets" and there was "put aside" the "assigned securities". The fact that the "assigned securities" were put away with the corporation is not of importance according to that decision. *This is especially true when the property which was put aside did not belong to the corporation but belonged to others who placed the securities with the corporation for a specific purpose.* Thereby a trust was created under the decision of this court (159 U. S. 312) cited there.

The *Bank of America* case (92 F. (2d) 97) which is relied on, involved a question between beneficiaries of a trust and creditors on the point whether the beneficiaries were partners. It was not a question whether the trust was valid *between the parties,* namely, the trustee and the beneficiaries.

The *Collins* case (91 F. (2d) 582) did not involve the question as to a trust *res* and only involved the question of an "equitable duty."

There is not a single authority which tends to support the proposition that as between the parties, the trustee and the beneficiaries, the former may be absolved from liability for a breach of trust on the ground that it was not possessed of a trust res, when it had the power to obtain the trust res in the event of a default, and all rights of action were vested in it.

The Trustee which *accepted its trust duties* and caused the notes to be issued *is in no position to claim that there was no trust and it is estopped from making such a de-*

fense. Having acquired all the rights and remedies from the noteholders it does not lie in its mouth to say that it had no trust relationship to them. While as against third parties possession may be necessary for the validity of a pledge it is not necessary between the parties. Title is not required for the validity of a pledge, nor is possession necessary for the validity of a trust (*Casey* v. *Cavarec,* 96 U. S. 467).

The "segregated assets" and "assigned securities" constituted pledged assets or a trust *res,* as long as no rights of third parties had intervened at the date of the "offer". The *"setting apart of designated personal property"* for the payment of a debt constituted a valid pledge between the parties (*Gluck* v. *Therme,* 154 Iowa 201; *Casey* v. *Cavarec,* 96 U. S. 467; *Sammet* v. *Mayer,* 108 F. (2d) 337, C. C. A. 2).

The part of the agreement which provided that the "segregated assets" shall not be "deemed" as a pledge or mortgage was repugnant to the previous provisions of the trust instrument containing elements of a pledge or mortgage and it is well settled that where two clauses are repugnant the first will be retained and the second rejected (*Thomas Hart Co.* v. *Newman Co.,* 365 Ill. 160, 166; 13 C. J., p. 536). Besides, *it did not apply to the "assigned securities" which were pledged.*

The Trust Res. The statement that the assigned securities were not to be held in trust is contrary to the record. The assigned securities were not the property of the corporation but belonged to its principal officers. Under the terms of the agreement these securities were to be deposited with the corporation and to be *held by it for specific purposes. The cor-*

poration was the agency of the Trustee, and all rights of action thereunder were vested in the Trustee. The agreement provided (R. 111):

> "The corporation agrees to receive, hold and dispose of such securities * * * under the provisions hereof."

It further provided:

> "This agreement is made for the exclusive benefit of the holders of said notes and the Van Sweringens."

This agreement, therefore, contradicts the statement of the respondents (p. 9) that the so-called assigned securities were not to be held in trust.

Benefits Received. The argument (p. 12) that the respondents did not receive any part of the segregated assets or assigned securities is refuted by the record. The offer stated that there was in the segregated assets and assigned securities, assets of $13,440,681.86 and there were outstanding securities of $26,234,000 (R. 71). It is shown by the record that $1,213,000 in notes were *not exchanged* (R. 34) and such notes did not participate in the segregated assets. Deducting the $1,213,000 from $26,234,000 there was left $25,021,000 which participated in the $13,440,681.80 to whom 50% was paid in cash, or $12,510,500. This left a balance of $930,181.80, which was turned over to the respondents under the secret agreement made with Morgan, which stated (R. 72) that "the remaining assigned securities will be withdrawn by the Van Sweringen interests" and it is shown by the affidavit of the respondents that all of these assigned securities were turned over to the respondents (R. 30-34). Besides, it is also shown (R. 33) that $65,779.21 was taken out from the

segregated assets to purchase a $71,000 participation in a $553,000 loan made in November, 1931 by J. P. Morgan & Co. to the Higbee Company.

The amount of the profit or gain is of no importance (*Anglo-Col. National Bank* v. *Lazard,* 106 F. (2d) 693).

In connection with petitioner's statement that as a result of the offer they were able to substitute $13,784,000 of the notes for the worthless stock as collateral, counsel say (p. 13) that: "This is a most misleading statement." *They do not deny that they received $13,784,000 in notes* and substituted them as collateral for the worthless common stock. They say that these notes were acquired in exchange for the "assigned securities" and not in exchange for the common stock. The fallacy of this contention is apparent. They were in no position to lay their hands on the "assigned securities" if the offer was not accepted. The only way they were able to obtain the assigned securities was by means of the offer whereby they cancelled the outstanding notes to the extent of $15,000,000 and thereby the assigned securities were released. *By one device or another they did substitute in their portfolio the $13,784,000 notes for the worthless stock as collateral.*

The statement that the bankers released their rights to over $7,500,000 of the assigned securities is unsupported by anything in the record.

The argument that the bankers did not use the notes to enforce collection of the $27,000,000 open account and merely held the notes as part of the collateral until September, 1935 when they were sold, is devoid of merit. The respondents were in control of the Van Swerinen

Empire and were not concerned with pressing their debts for collection. Their only concern was to prevent *other creditors from pressing their debts for collection and* thereby disrupt the empire. By the scheme employed the other creditors were eliminated and everything was placed in the control of the respondents who used the assets as long as they could milk them and when everything was gone they resorted to the sale followed by the bankruptcy.

Breach of Trust. The contention that if there was a fiduciary relationship there was no violation of duty, is also without merit. They say (p. 14) that the "moving consideration" for making the offer "was to stop the private purchase of the notes by the Van Sweringen Corporation with the segregated assets". Why were they, who claimed to have owed no fiduciary relationship to the noteholders, concerned in stopping such a purchase? If they did want to stop it all that was necessary for them to do was to inform the noteholders that there were available assets for them at 50c on the dollar and they certainly would not have sold the notes at 30c on the dollar. Whatever the motive might have been, it was the duty of the fiduciaries to inform the beneficiaries of the existing facts and not to conceal them from them. If it be true, as they now say (p. 17), that the respondents came to the conclusion that the only alternative was insolvency proceedings and that the offer of the common stock was only "in the event security values" improved, *this was not reflected in the offer which they then made public.*

Loss Sustained. The contention that the petitioner did not show any loss is contrary to the record. The matter was fully discussed in the petition for rehearing which was filed in the Circuit Court (R. 165-167) there is no need for repetition.

Elements of Fraud. The point (p. 3) that the essential elements of an action for misrepresentation are completely lacking, of course, involves the merits and is improper to be argued on a petition for writ of *certiorari*. Having raised the point, however, we will briefly answer it. The five elements are essential for "actual fraud" and *are not essential for a "constructive fraud"* embracing a breach of a fiduciary duty (26 C. J., pp. 1060-1; 23 Am. Jur., p. 757). If the petition will be granted we will then show that *all* of the necessary elements constituting an action for fraud were present.

The Senate Report. It is urged that the report of the Senate Commission should not be considered by this court. No authorities are cited. In another part of their brief counsel claim that J. P. Morgan & Co. were total *strangers*. Even the District Court held that by reason of the participation of J. P. Morgan with the Guaranty Trust Company in the $23,500,000 note *it stood in the same capacity as the Trustees* (R. 142). However, it appears from the Senate Report that J. P. Morgan participated in floating the $30,000,000 note issue and that its share of the compensation was 20,000 in warrants (See Senate Report 714, Part 3, Exhibit VS-590, page 1020, and Exhibit VS-598 at page 1038).

For the foregoing reasons we urge that the writ of *certiorari* be allowed.

Respectfully submitted,

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